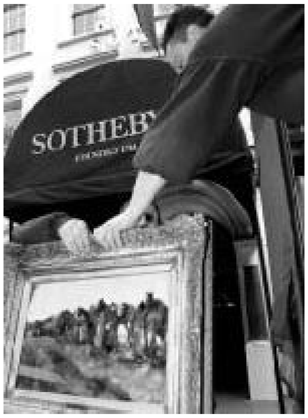
August 11 1998 **ECONOMIC VIEW**

As it moves towards a single currency, Brussels is succumbing to over-regulation



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London's auction houses were dealt a body blow by an EU accord on VAT on art sales

Europe turns its back on the secrets of success

Battling down the wind tunnels called pedestrian walkways in the heart of Coventry on a sodden February day some years ago, I reflected how blessed were the towns of England whose planners were idle sods interested only in their golf handicaps. By design and at huge expense, the city fathers had compounded the desolation of Hitler's bombing of the great cathedral. Urban architects have always seemed to me in need of some sort of equivalent to the Hippocratic oath - if not "do no harm", then at least "let well alone". So, even more acutely, have the "architects" of the EU.

In 1985, after years of regulatory fervour, the European Community took that precautionary principle at least partly on board. The launching of the 1992 single market programme that December, with the Single European Act, was a blow for liberalisation, a revolt against the passion for standardising everything in Brussels that had infected the EC with "Eurosclerosis". But in 1998, under the spell of imminent economic and monetary union, both governments and the Commission are in danger of reverting to bad old habits. The signs are everywhere that the zealous

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planners are making a comeback.

The key insight grasped in 1985 was that the free movement of goods and services in Europe did not require, and could even be hindered by, rigid uniformity. "Harmonisation" of national laws and regulations was strangling rather than promoting the common market objective of the original Treaty of Rome. Over-regulation had created the unloved Europe of persecuted cheesemakers, obscure committees discussing the proper size of teddy bears' eyes and the famous ten-year argument over the height and size of tractors' rear lights. Most damagingly, the Brussels-centred concept of the "level playing field" had also proved a wonderfully convenient alibi for protectionist lobbies. It became clear that there would never be a genuinely open single market in Europe unless limits were set to the manic codifying of every conceivable economic activity.

Free-market reformers such as Lord Cockfield and Sir Leon Brittan persuaded governments instead to adopt, under the Single European Act and the 1992 single market programme, the radical alternative of "mutual recognition" by all member states of each other's laws, regulations and standards. The principle governing the vast new pile of single market directives was that formal harmonisation should be kept to the strict minimum "necessary to ensure a proper functioning of the single market", to protect consumers and, in services, to serve the needs for prudential regulation. The 1992 market-opening drive operated on the assumption that free trade could be based on national standards, provided these met an agreed EU-wide minimum - and that competition law could do well what detailed regulation could only do badly. It made for a more flexible economic dynamic.

Some Commission bureaucrats, and some governments, admittedly seized on that innocent "minimum standard" proviso as a side door to continued centralised regulation. The Brussels culture is not easily changed. At an all too typical lunch there not long ago, a group of the Commission's finest spent forty minutes complaining that ministers had turned down their proposed directive compelling all EU fire brigades to conform, at huge expense, to a single standard for protective clothing. The 1992 programme gave the Commission a new, much healthier role as competition's watchdog.

The change of approach was a fresh response to the question, What kind of Europe? which showed that the EU did not have to be an over-regulated monster. Because harmonisation extends the power of the state at the expense of individual freedoms, while competition sets people free, there should be a presumption against it unless the benefits unequivocally outweigh the costs.

That is why it is depressing that "harmonisation" is once again the EU watchword - on taxation, forseeably also in social security, and as a supposed condition for the effective integration of EU financial markets and the success of the single currency. The truth about EMU is that the precise opposite is true: when countries cannot use exchange rates as policy tools, something has to take their place, and that puts a premium on competitive labour markets and flexible fiscal policies.

Yet Austria, which took over the EU presidency last month, is pushing to close the gap between tax rates in different EU countries - and where Austria pushes, Germany is actively lending muscle. At the Bundesbank, Hans Tietmeyer has after all consistently held the view that with EMU, "it is an illusion to think that states can hold onto their autonomy over taxation policy".

For harmonisation, read tax rises if you are British; the tax take in this country is 38 per cent, compared with an EU average of more than 45 per cent. There are schemes for EU-wide withholding taxes on savings, a common "floor" rate for corporation taxes and a new energy tax. Is income tax likely to stay off the agenda for long, given that basic rates are 23 per cent in this country, but 29 per cent in Germany and 33 per cent in France?

The British Government has put it about that it will resist such encroachments on sovereignty tooth and nail and will, in particular, veto any additional burden on British taxpayers. Since all fiscal decisions must be unanimous, that should be the end of the matter. But don't bet on it. So, even more vehemently, said the Major Government - the very government that in 1994, voluntarily sold the London art market down the river when it agreed to an EU-wide regime of VAT on art sales.

In EU matters, political trade-offs have a curious way of shouldering principle aside. If the last, relatively Eurosceptic and determinedly free-market government could be strong-armed into damaging London's world-beating fine arts auction-houses - a business that employs 50,000 people and has a turnover of £2.2 billion - what should be expected of one that is conspicuously anxious to prove Britain's credentials as a "good European"? A month ago, Helen Liddell, then a Treasury minister, emerged from an Ecofin meeting saying happily that everybody had "welcomed the broad themes" set out by the Austrian presidency. And Gordon Brown cheerfully signed up last December to a "voluntary" code of conduct on "unfair" tax competition - a term left perilously ill-defined.

The Government claims that the innocent objective is to close loopholes and eliminate tax evasion. That is not the way his colleagues, or the Commission, see it. They want a minimum level of corporation tax to stop "harmful" competition. Their argument is that with a single currency and mobile capital markets, such a floor is needed to stop a "race to the bottom" as countries compete for inward investment, forcing governments to compensate with higher taxes on labour - leading to higher unemployment. This is flawed logic. Skills and social security charges can influence investors quite as powerfully as corporate tax rates. The truth is that the major continental EU governments, reliant on high tax regimes, would rather suppress competition than cut spending and the appetite for tax revenue.

The EU code of conduct slips the padlock off the door. It may be voluntary now; but the social chapter, which also began as voluntary measure, has acquired teeth far sharper than Tony Blair admitted when he signed Britain up to it with the breezy assurance that Britain would never have to go along with measures that it did not approve.

In Brussels, a committee on harmful tax competition is now hard at work. Mario Monti, the EU taxation commissioner, sent it last month a confidential list of 75 different taxes to review. The Commission's proposed 20 per cent minimum withholding tax on savings would simply drive savers outside the EU. Britain has joined Luxembourg in calling for an independent investigation. How naïve can you get? Mr Monti's ambitions do not end there. He sees the advent of Internet marketing as one more excuse for ending Britain's zero VAT rate on children's books, clothes, and food. His hope is that under EMU, the integration of markets and institutions will make it easier "to aim for a much higher degree of tax homogeneity".

Politics, notably the fear that transparency will accentuate the mobility of capital and investment decisions, is turning the best economic arguments for EMU on their head. Just when enlargement demands more subsidiarity and greater imagination about a multi-system Europe, the EU is marching forward to the over-regulated past. The next formal event on the EU calendar, the October mini-summit in Vienna on "the future of the Union", is supposedly about defining limits to Community action. Don't bet too much on that, either.

ROSEMARY RIGHTER

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